

Ag Decision Maker

A Business Newsletter for Agriculture

Vol. 14, No. 6

www.extension.iastate.edu/agdm

April 2010



2009 Farm and Rural Life Poll: farm policy and commodity production*

by J. Gordon Arbuckle, Jr., extension sociologist; Paul Lasley, extension sociologist; Peter Korsching, professor; and Chris Kast, research assistant.

The Iowa Farm and Rural Life Poll is an annual survey that collects and disseminates information on issues of importance to rural communities across Iowa and the Midwest. Conducted every year since its establishment in 1982, the Farm Poll is the longest-running survey of its kind in the nation. This article highlights information from the 2009 survey on farm policy and commodity production.

Farm policy and commodity production

When the Farm Poll survey was mailed in January 2009, the 2008 Farm Bill had been in effect for six months, giving farmers and the farming community some time to learn about changes and continuities in the legislation and reflect on what they might mean for them. The survey included questions that focused on farm policies and programs and their potential effects on farmers, farming practices, markets and rural communities.

A first set of items allowed farmers to assess some general statements about the impacts of commodity programs. Two statements about ethanol policy received the highest levels of endorsement, with 72 percent of participants agreeing that federal ethanol policy had been good for Iowa farmers, and 71 percent supporting an increase in the percentage of ethanol that can be blended into gasoline.

(See Table 1.) A third ethanol-related item—that ethanol policy should focus more on developing cellulosic and other non-grain forms of biofuels—earned much less support, with only 37 percent agreeing with that statement and 44 percent expressing uncertainty.

Farmers' general assessments of commodity programs were uneven. Seventy percent of farmers agreed that every time the Farm Bill is renewed they worry about how changes will affect their operations (Table 1). This indicates that uncertainty about Farm Bill policies and programs can be a source of stress. On the other hand, a majority of participants also agreed that commodity programs have been good for most Iowa farmers (57 percent) and that they have served as an important safety net for their operations (55 percent). Finally, however, a sizeable minority (46 percent) of participants agreed that commodity programs favor agribusiness corporations over farmers.

A number of statements focused on the specialized production of commodities such as corn, soybeans, hogs and cattle and the impacts of that specialization on farmers and rural communities. The statement "Profit margins on corn and soybeans get eaten up by land rents and input costs faster than they used to" received the highest levels of endorsement, with 86 percent of farmers in

agreement (Table 2). Seventy-two percent of farmers agreed that increasing specialization in commodities has led to the loss of farms, 68 percent agreed that they sometimes feel like they have little control over the profitability of their

continued on page 2

Handbook updates

For those of you subscribing to the handbook, the following updates are included.

Historical Costs of Crop Production
-- A1-21 (2 pages)

Proven Yields and Insurance Units for Crop Insurance -- A1-55 (4 pages)

Historic Iowa Farm Custom Rate Survey-- A3-12 (3 pages)

County Farmland Values -- C2-72 (10 pages)

Farmland Value Survey (Realtors Land Institute) -- C2-75 (2 pages)

Please add these files to your handbook and remove the out-of-date material.

continued on page 6

Inside . . .

Financial challenges facing farm enterprises... Page 3

IOWA STATE UNIVERSITY
University Extension

Ag Decision Maker is compiled by
Don Hofstrand, dhof@iastate.edu
extension value-added specialist and
co-director of the Agricultural Marketing Resource Center

2009 Farm and Rural Life Poll: farm policy and commodity production, continued from page 1

farms, 55 percent agreed that overreliance on corn and soybeans contributes to financial risk for row crop farmers, and 50 percent agreed that farmers have to continually increase acreage in order to make a living farming corn and soybeans.

Two statements focused on the long-term impacts that specialization trends have had on Iowa's farmers and rural communities. The first asked participants to rate their agreement or disagreement with the statement "The shift away from diversified farm operations and toward specialized grain or livestock operations has generally been good for Iowa's farmers." Only 19 percent of farmers agreed with that position, and 48 percent either disagreed or strongly disagreed (table 2). In response

to an identical statement regarding rural communities, even fewer farmers agreed (14 percent) and many more disagreed (55 percent) that a greater reliance on specialized commodity production has been good for rural communities.

Finally, several items centered on markets and cropping decisions. The argument is often heard that commodity programs discourage farmers from diversifying into non-traditional crops. However, 70 percent of farmers agreed that they would plant the same mix of crops and livestock even if there were no commodity support programs in place. Thirty-five percent agreed that the shift to corn and soybeans as the dominant crops has reduced market opportunities for other crops. Only

Table 1. Farm policy and commodity production, part 1

	Strongly Disagree	Disagree	Uncertain	Agree	Strongly Agree
—Percentage—					
Federal ethanol policy has generally been good for Iowa farmers	3	6	19	54	18
The percentage of ethanol that can be blended into gasoline should be increased	3	6	21	44	27
Each time the Farm Bill is renewed I worry about how changes will affect my operation.....	3	9	18	52	18
Commodity programs have been good for most Iowa farmers	4	11	30	53	4
Commodity programs have been an important safety net for my farm operation	6	14	25	45	10
Commodity programs favor agribusiness companies over farmers	2	12	40	33	13
Ethanol policy should focus more on developing cellulosic and other non-grain forms of biofuels	4	15	44	29	8

Table 2. Farm policy and commodity production, part 2

	Strongly Disagree	Disagree	Uncertain	Agree	Strongly Agree
—Percentage—					
Profit margins on corn and soybeans get eaten up by land rents and input costs faster than they used to	1	4	10	48	38
Increased specialization in commodities (corn, soybeans, hogs, etc.) has led to loss of farms.....	2	8	19	42	30
If there were no commodity programs, I would still produce the same mix of crops/livestock	1	6	24	60	10
Sometimes I feel like I have little control over the profitability of my farm.....	3	16	13	54	14
Too much reliance on corn and soybeans contributes to financial risk for row crop farmers	1	14	30	48	7
To make a living producing corn and soybeans, farmers have to continually increase acreage	4	22	24	41	9
The shift to corn and soybeans as the dominant crops has led to a decline in markets for other crops.....	4	26	36	29	6
If there were no commodity programs, Iowa farmers would grow more fruits, nuts, vegetables, and other non-program crops	6	31	45	15	3
The shift away from diversified farm operations and toward specialized grain or livestock operations has generally been good for Iowa's farmers	16	32	34	18	1
The shift away from diversified farm operations and toward specialized grain or livestock operations has generally been good for Iowa's rural communities	19	36	30	12	2

continued on page 3

2009 Farm and Rural Life Poll: farm policy and commodity production, continued from page 2

18 percent agreed that in the absence of commodity programs, Iowa farmers would grow more fruits, nuts, vegetables and other non-program crops.

Survey information

Iowa State University Extension, the Iowa Agriculture and Home Economics Experiment Station and the Iowa Department of Agriculture and Land Stewardship are all partners in the Farm Poll effort. The information gathered through the Farm Poll is used to inform the development and improvement of research and extension programs and is used by local, state and national leaders in their decision-making processes. We thank the many farmers who responded to this year's survey and appreciate their continued participation in the Farm Poll.

Who participates?

The 2009 Farm Poll questionnaires were mailed in January and February to a statewide panel of 2,201 farm operators. Usable surveys were received from 1,268 farmers, resulting in a 58 percent response rate. On average, Farm Poll participants were 64 years old, and had been farming for 39 years. Fifty percent of farmers reported that farm income made up more than half of their overall 2008 household income, and an additional 20 percent earned between 26 and 50 percent of their household income from farming. Copies of this or any other year's reports are available from your local county Extension office, the Extension Distribution Center (www.extension.iastate.edu/store), Extension Sociology (www.soc.iastate.edu/extension/farmpoll.html), or from the authors.

**Reprinted with permission from the Iowa Farm and Rural Life Poll, 2009 Summary Report, PM 2093. Renea Miller provided valuable layout assistance to the questionnaire and this report. The Iowa Department of Land Stewardship, Division of Statistics, assisted in the data collection.*

Financial challenges facing farm enterprises*

By Jason Henderson, Omaha Branch Executive, Maria Akers, Associate Economist

As the outlook for the U.S. economy improves, agricultural enterprises are once again considering new investment opportunities. But searching for financing has become a challenge. In 2009, volatility in agricultural markets jumped and farm profits dropped, while the risks associated with lending intensified. In response, agricultural lenders raised their credit standards. Now, as new profit opportunities in the farm sector emerge, many potential borrowers from all segments of the industry wonder if credit will be available.

This article describes the factors that shape credit availability for agriculture. The article begins by examining the relatively strong performance of agricultural banks during the financial crisis. It then examines how lending risks have kept credit conditions tight despite the easing of the crisis. Finally, the article explores how new profit opportunities and lower debt levels should improve credit availability for many producers in the year ahead. Those facing the most difficulty in getting credit are livestock producers, whose thin profit margins and high debt levels are likely to continue in 2010.

Agricultural bank performance in the financial crisis

With fragile financial markets, agricultural producers have concerns about financing agricultural investments. Even though agricultural banks outperformed their banking peers during the recession, bank profits declined. Still, agricultural bankers report having ample funds for farm loans at historically low interest rates.

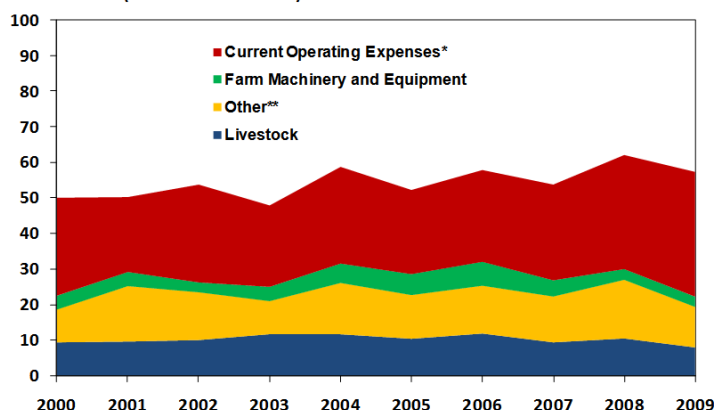
Agricultural banks outperformed banks nationwide during the recent financial crisis but still saw profits fall sharply. In the third quarter of 2009, agricultural banks saw their rate of return to assets and equity drop to roughly half their pre-financial crisis levels. At agricultural banks, the average rate of return to assets and equity fell to 0.6 and 5.5, respectively. In contrast, other small commercial banks reported negative returns to assets and equity. During the entire year, less than ten agricultural banks failed, while closures of commercial banks soared to 140.

With stronger profits than their peers, agricultural banks have consistently reported that funds have been available for creditworthy borrowers in the farm sector. Throughout the recession, most bankers responding to Federal Reserve Bank agricultural credit surveys reported that funds were available for non-real estate farm loans. In the Kansas City District, few agricultural loans were denied due to a shortage of bank funds. Loan approval decisions were based primarily on projected cash flow from farm operations and the amount of collateral pledged (Briggeman and Akers).

The ample funds at agricultural banks have supported a high volume of low-interest loans to the farm sector. According to the Agricultural Finance Databook, the total volume of non-real estate agricultural loans at commercial banks declined slightly in 2009 from the year before but remained above the ten-year average (Chart 1). Over the past few years, however, the composition of the average farm loan portfolio at agricultural banks has shifted. The proportion of loans to support current operating expenses rose from 45 percent in 2005 to over

Chart 1: Agricultural Non-Real Estate Loan Volume

Billion Dollars (2000 constant dollars)



Source: Agricultural Finance Databook

* Includes expenditures for crop production and the care and feeding of livestock

** Typically loans for which the lender does not know the purpose

continued on page 4

Financial challenges facing farm enterprises, continued from page 3

60 percent in 2009. This increase in operating loans was driven by surging production input costs, especially for fuel, fertilizer and livestock feed. Various national and regional Federal Reserve surveys on farm lending also reported a steady drop in farm interest rates for short-term operating loans, intermediate-term machinery and equipment loans, and long-term real estate loans.

Credit standards rise with loan defaults

Even though agricultural banks have performed better than other commercial banks in general, the repercussions of the recession and financial crisis remain. Declining farm incomes in 2009 depressed repayment rates and raised delinquency and charge-off rates on agricultural loans. As a result, commercial banks have tightened credit standards by maintaining elevated collateral requirements and stringent loan terms.

During the recession, shrinking profit margins raised agricultural lending risk. In 2009, net farm income declined 35 percent as softer commodity prices, coupled with elevated input costs, trimmed agricultural profits. Lower farm incomes hindered the ability of agricultural producers to service debt during the year. In regional Federal Reserve surveys, agricultural bankers reported that farm operating loan repayment rates were lower in 2009 than in the previous year. At the same time, survey respondents indicated that requests for loan renewals and extensions grew rapidly.

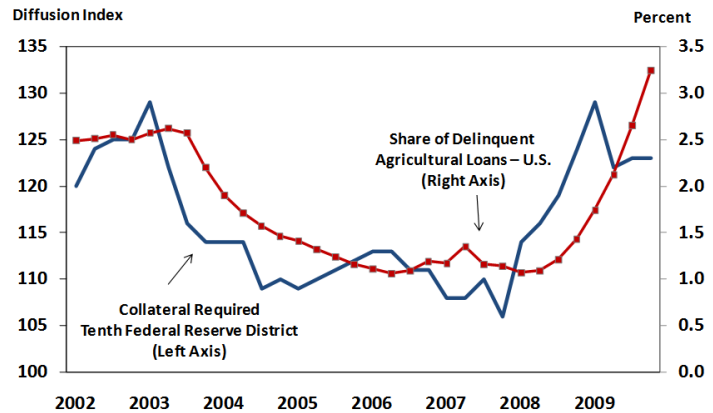
Moreover, loan delinquency and charge-off rates have risen as the number of non-performing loans increased. Delinquent, nonperforming agricultural loans at commercial banks rose from 1.07 percent of such loans in the first quarter of 2008 to 3.24 percent by the fourth quarter of 2009 (Chart 2). During the same time, the portion of agricultural loan charge-offs rose even more rapidly, from 0.09 to 0.58 percent of agricultural loans. While these delinquency and charge-off rates remain well below those on other types of loans, delinquency rates on agricultural loans were still rising at the end of 2009.

In response to lower loan repayments and rising delinquency and charge-off rates, bankers have boosted the risk rating and collateral requirements on agricultural loans. Banks assign risk ratings to loans based on the borrower's expected payment performance, which typically incorporates both the borrower's history of debt repayment and current financial prospects. Since 2008, the risk ratings on agricultural loans have climbed steadily, and respondents to Federal Reserve surveys reported raising collateral requirements for farm loans (Chart 2). Some respondents noted that loan-to-value ratios have declined for farm real estate purchases, requiring larger equity positions from borrowers (Henderson and Akers).

Farm profits and debt shapes credit availability

While credit standards will likely remain elevated in the year ahead, credit availability to agricultural enterprises could improve. Profitability shapes credit availability, and stronger farm incomes in 2010, coupled with a resurgent global economy, should help improve access to credit as the year progresses. With improved profitability, farm debt levels could remain low, further enhancing credit access. Still, agricultural enterprises facing weak profit opportunities and high debt

Chart 2: Collateral Requirements and Delinquency Rates on Agricultural Loans



Source: Federal Reserve Bank of Kansas City and Federal Reserve Board of Governors

levels will find obtaining credit difficult. Many livestock operations, in particular, could confront a stiff challenge.

A rebound in 2010 farm income should improve farmers' ability to tap credit for operating needs. USDA projects that, after falling in 2009, net farm income will increase 12 percent in 2010 with stronger livestock receipts and stable cash expenses. Longer term, USDA expects net farm incomes to rise further over the next decade as net returns to crop production hold at historical highs with a sustained recovery in livestock profits.

In 2010, crop producers are expected to enjoy another year of robust profitability. Farm prices for most of the major program crops – corn, soybeans, wheat and cotton – are expected to rise, though rice prices may edge down from record highs due to increased production. After surging in recent years, crop production costs are expected only to edge up in 2010. As a result, crop profits are projected to remain historically high, but well below the record peaks in 2007 and 2008 (Chart 3).

After struggling to cover costs, livestock producers could see profit opportunities brighten at the end of 2010. Since 2007, cattle, hog, dairy and poultry producers have suffered through extended periods of economic loss. Heading into this year, profit losses narrowed and USDA projected that net returns would strengthen with stronger protein demand in an economic recovery (Chart 4). The return to profitability and stronger cash flow should improve the availability of credit to the livestock sector.

Rising profitability could help keep farm debt levels low, further enhancing the farm sector's ability to access credit. Since the 1980s farm crisis, fewer farms have reported using debt to finance operations. Only 31 percent reported using debt in 2007, compared to 60 percent in 1986. As a result, farm balance sheets remain relatively healthy, and historically low debt ratios have limited financial risk to the farm sector.

Debt remains high for large farms, livestock operations and young farmers

Still, the debt ratios of a small subset of farmers remain relatively high. Larger farming operations, livestock operations and operations owned by young and less experienced farmers typically have higher debt ratios and less ability to service debt

continued on page 5

Financial challenges facing farm enterprises, continued from page 4

than other farm operators. As a result, overall industry averages mask some of the financial risks in the agricultural sector that could arise with high debt levels.

Higher debt levels can place more pressure on a borrower's ability to repay debt with current income. One measure of the ability to repay debt is the debt repayment capacity utilization (DRCU) index, which takes into account debt obligations in relation to maximum debt repayment capabilities. A DRCU index below 100 indicates that the borrower has enough income to service the debt. Conversely, a DRCU index above 100 infers the borrower does not have enough income to service the debt. Therefore, a lower DRCU index implies a stronger debt repayment position for the borrower.

USDA reports that three types of farm operations tend to have higher debt levels (Harris et. al). First, according to the Agricultural Resource Management Survey (ARMS), larger farming operations tend to have higher levels of debt. In 2007, farms with annual sales up to \$100,000 had a DRCU index below 15. In contrast, farms with annual sales between \$100,000 and \$5 million had an average index between 25 and 30, and farms with more than \$5 million in annual sales had an index of 37. Larger farm operations tend to be more capital intensive, using more equipment and machinery than smaller farms. Moreover, farm earnings are the primary source of income for larger farm operations, while smaller farms tend to have a greater reliance on off-farm incomes (Harris et.al).

Second, livestock operations also have higher debt use in recent years due to shrinking profit margins. In 2008, hog farms had the highest DRCU at 47, followed by poultry at 44 and dairy and cattle operations at close to 40. Debt utilization increased between 2004 and 2008 for poultry, hog and cattle operations as profit margins plunged, due in large part to rising feed costs. In contrast, crop operations had DRCU levels below 30 percent in 2008, and their debt utilization diminished from 2004 to 2008 (Chart 5).

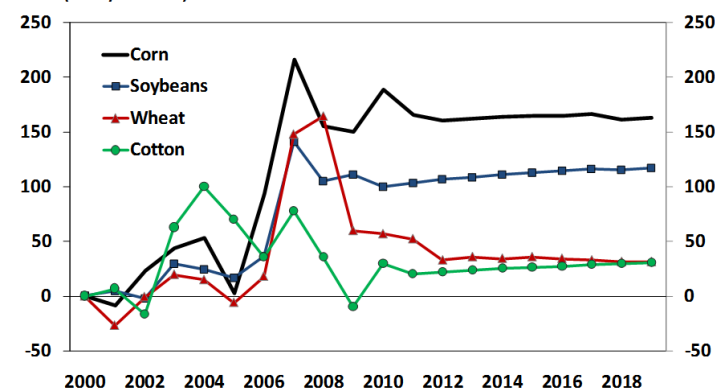
Third, operations owned by young and less experienced farmers also tend to have high debt levels as they are typically still financing the initial start-up costs of a farm operation. Traditionally, farm operations use debt to finance land, equipment, and machinery purchases, and younger farm operators with less equity in the farm operation tend to have higher debt levels than older, more experienced farmers. In 2008, 56 percent of all farm enterprises headed by operators younger than 35 had debt, compared to only 19 percent headed by farmers 65 or older. Moreover, the debt-to asset ratio was highest (21.1 percent) among farm operations headed by the younger farmers.

Given current profit projections and debt levels, it appears the greatest financial risk in agriculture could emerge in larger operations in the livestock sector. As a result, the livestock sector could face the most difficulty obtaining credit. Dairy, hog and cattle feeding enterprises operated in the red for most of 2009, as livestock prices remained well below costs of production. Losses are expected to narrow in 2010 as USDA projects livestock prices to rise amid stronger demand and shorter supplies.

Chart 3: Net Returns to Crop Production

(Gross Market Returns minus Variable Costs)

Index (base year 2000)



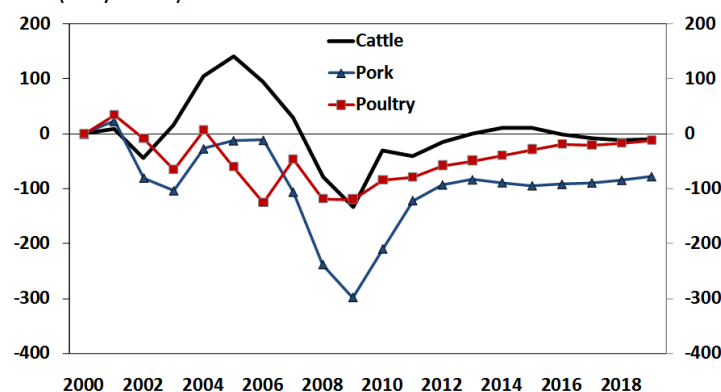
Source: USDA

Variable costs exclude costs for labor and management, depreciation, land, taxes, insurance, and farm overhead.

Chart 4: Net Returns to Livestock Production

(Returns above cash costs)

Index (base year 2000)

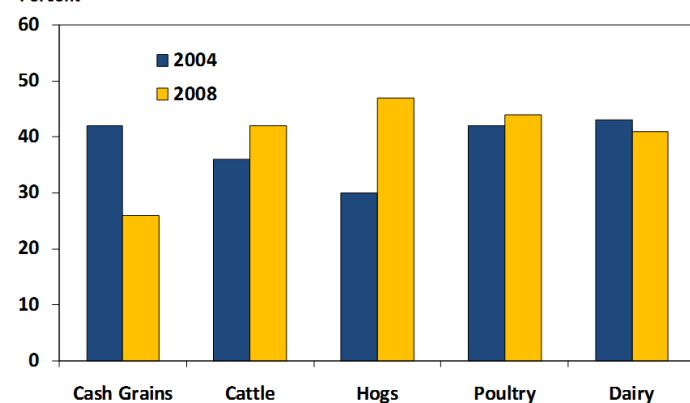


Source: USDA

Net returns are returns above cash costs.

Chart 5: Debt Repayment Capacity Utilization (DRCU) by Production Sector

Percent



Source: USDA

continued on page 6

Financial challenges facing farm enterprises, continued from page 5

Still, loan volumes for feeder cattle and dairy production are expected to decline further in 2010. In 2009, the total loan volumes made by commercial markets for feeder and other livestock fell from \$13.0 to \$11.1 billion. Agricultural bankers responding to Federal Reserve surveys in the Chicago and Dallas districts expected that loan volumes for feeder cattle and dairy industries would continue to decline in 2010. While the interest rates on livestock loans fell below 5 percent in 2009, commercial banks reduced loan maturities and raised collateral requirements to mitigate their risk exposure to the sector. But, improving profit opportunities in 2010 should help lessen some of these financial challenges.

In sum, brighter profit opportunities and low debt levels should improve access to credit for agricultural producers in 2010. In general, agricultural banks remain in solid financial condition and have ample funds available for agricultural loans at historically low interest rates. The recession cut demand for agricultural products and raised the risks surrounding agricultural loan activity, as evidenced by higher delinquency and charge-off rates. The biggest challenges have emerged among livestock enterprises struggling with economic losses and higher debt levels. Still, overall farm debt levels remain near historical lows, and a rebound in farm profits

should bolster farm income statements and balance sheets. A farm rebound, spurred by a global economic recovery, could open credit flows and foster additional investments in U.S. agriculture.

References

Agricultural Finance Databook. 2009. Federal Reserve Statistical Release E.15. Board of Governors of the Federal Reserve System. www.federalreserve.gov/releases/e15/current/pdf/databook.pdf

Briggeman, Brian and Maria Akers. 2009. "Farmland Values Hold Steady and Farm Credit Conditions Deteriorate." Survey of Tenth District Agricultural Credit Conditions. Third Quarter, Federal Reserve Bank of Kansas City. www.kansascityfed.org/Agcrsurv/AGCR3Q09.pdf

Harris, J. Michael, et. al. 2009. "Agricultural Income and Finance Outlook." Economic Research Service, U.S. Department of Agriculture, AIS-88, December. <http://usda.mannlib.cornell.edu/usda/current/AIS/AIS-12-22-2009.pdf>

USDA Agricultural Projections to 2019. 2010. Office of the Chief Economist, World Agricultural Outlook Board, U.S. Department of Agriculture. OCE-2010-1, February. www.ers.usda.gov/Publications/OCE101/OCE101.pdf

**Originally published in Issue I, 2010 of the Main Street Economist, a publication of the Federal Reserve Bank of Kansas City.*

Updates, continued from page 1

Internet Updates

The following updates have been added on www.extension.iastate.edu/agdm.

Computing a Cropland Cash Rental Rate -- C2-20 (4 pages)

Flexible Farm Lease Agreements -- C2-21 (4 pages)

A Marketing Primer for Businesses -- C5-15 (2 pages)

How Much Should I Spend on Marketing -- C5-16 (1 page)

Where to Find Information for Doing Marketing and Business Studies -- C5-21 (3 pages)

Marketing Research Tools -- C5-22 (2 pages)

Marketing Research – Finding the Best Consultant to Hire -- C5-24 (2 pages)

Do you Know Your Customer? -- C5-25 (2 pages)

Finding Your Facts - A Quick Guide to Developing a Questionnaire -- C5-26 (2 pages)

Understanding Consumers -- C5-27 (2 pages)

Conducting a Competitive Analysis - Is There Room for Your Business? -- C5-29 (3 pages)

Value-added Business Success Factors: The Role of

Management and Operations -- C5-185 (2 pages)

Value-added Business Success Factors: The Role of Local Infrastructure and Support -- C5-186 (2 pages)

Romance vs. Reality: Hard Lessons Learned in a Grass-fed Beef Marketing Cooperative -- C5-220 (6 pages)

Managing Farm Business and Family Stress -- C6-51 (2 pages)

Decision Tools and Current Profitability

The following tools have been added or updated on www.extension.iastate.edu/agdm.

SURE Payment Calculator – A1-44

Season Average Price Calculator – A2-15

Corn Profitability – A1-85

Soybean Profitability – A1-86

Ethanol Profitability – D1-10

Biodiesel Profitability – D1-15

Returns for Farrow-to-Finish – B1-30

Returns for Weaned Pigs – B1-33

Returns for Steer Calves – B1-35

Returns for Yearling Steers – B1-35

... and justice for all

The U.S. Department of Agriculture (USDA) prohibits discrimination in all its programs and activities on the basis of race, color, national origin, gender, religion, age, disability, political beliefs, sexual orientation, and marital or family status. (Not all prohibited bases apply to all programs.) Many materials can be made available in alternative formats for ADA clients. To file a complaint of discrimination, write

USDA, Office of Civil Rights, Room 326-W, Whitten Building, 14th and Independence Avenue, SW, Washington, DC 20250-9410 or call 202-720-5964. Issued in furtherance of Cooperative Extension work, Acts of May 8 and July 30, 1914, in cooperation with the U.S. Department of Agriculture. Jack M. Payne, director, Cooperative Extension Service, Iowa State University of Science and Technology, Ames, Iowa.

Permission to copy

Permission is given to reprint ISU Extension materials contained in this publication via copy machine or other copy technology, so long as the source (Ag Decision Maker Iowa State University Extension) is clearly identifiable and the appropriate author is properly credited.